HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. ■ Ranking Democratic Member

214 O'Neill HOB ■ Washington, DC 20515 ■ 202-226-7200 ■ www.house.gov/budget_democrats

January 30, 2002

Raising the Debt Limit

Dear Democratic Colleague,

This year, perhaps as early as February, the Congress will vote on increasing the statutory limit on the public debt. The Administration had predicted a year ago that the debt limit increase wouldn't be needed until 2009, but Treasury Secretary O'Neill informed the Congress in December that action was urgently needed now.

Debate of this issue in the past has sometimes been characterized by misunderstanding. The attached analysis by the Democratic staff of the House Budget Committee attempts to clarify the issue. Specifically, our analysis examines what public debts are limited by statute, why the debt ceiling increase may now be needed, and how this need reflects Republicans' mismanagement of the budget.

I hope that you find the analysis helpful. Please don't hesitate to contact me or the Budget Committee Democratic staff at 226-7200 if you have questions.

Sincerely,

John M. Spratt, Jr.
Ranking Democratic Member

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On December 11, 2001, Treasury Secretary Paul O'Neill wrote the Congress requesting that the statutory debt limit be raised, something that hadn't been needed since August 1997. Secretary O'Neill asked for an increase from the current level of $5.95 trillion to $6.70 trillion, because the current debt limit might be breached as early as March. At the beginning of 2001, OMB had not expected the debt limit to be breached until 2008, while last year's Republican budget resolution predicted 2009.

The requested increase is needed to accommodate the deficits expected under current law in coming years and the growing public debt that results. The debt limit increase is a reflection of the sudden fiscal deterioration of the past year. Specifically,

- The Treasury Secretary's hasty call for a debt limit increase results from the fact that the budget has again slid into deficit.

- Even if the budget eventually returns to unified surplus, as the Administration will undoubtedly predict, the statutory debt limit will have to be raised repeatedly in coming years until we also return to saving trust fund surpluses.

- Thus, this new need to raise the debt limit in coming years is an indication that the Republican mismanagement of fiscal policy, most notably their $1.7 trillion tax cut, is undermining our ability to face the challenges of the Baby Boom's retirement.

What Debt Is Subject to the Statutory Limit?

Debt subject to statutory limit is the sum of two numbers: (1) debt held by the public and (2) debt owed to government trust funds, notably Social Security and Medicare. These two kinds of debt are added together to calculate debt subject to statutory limit, even though they are quite different.

Debt held by the public is the Federal government's total financial obligation to everyone outside the Federal government. Debt held by the public grows any time total revenues coming into the government fail to cover the cost of all Federal expenditures. Thus, debt held by the public grows whenever there is a unified budget deficit.

Debt held by the public is the part of the government's debt on which economists focus, because it measures the government's impact on financial markets. When the government borrows more from the public, that tends to crowd out private-sector borrowers and raise interest rates. This is why the Chairman of the Federal Reserve has argued that the evaporation of $4 trillion of budget surpluses over the next decade has been a factor in keeping long-term interest rates high, even though the Fed has lowered short-term rates aggressively.

Debt owed to government trust funds, the largest of which is Social Security, is intra-governmental debt. Although it doesn't impact financial markets the way that publicly held debt does, it is an important recognition of government's obligation to make good on the promised benefits that the trust funds represent.

For example, when Social Security runs surpluses, the law requires that the trust fund loan those surpluses to the Treasury. The trust fund receives Treasury bonds for the loan, and those bonds are an acknowledgment that the payroll taxes coming into the system imply a future obligation of the government to pay Social Security benefits. Thus, as long as Social Security is building up surpluses, this part of the debt subject to limit grows.

In 1999 and 2000, the Social Security surplus was used to pay down debt held by the public, and in 2000 debt subject to limit was essentially unchanged. That practice has now ended.

Why Must the Debt Limit Be Raised So Much Sooner than Previously Expected?

Debt subject to statutory limit grows any time the sum of its two components is rising. If the government is running unified deficits—which means that publicly held debt is rising—and the various trust funds are running surpluses—which means that trust fund debt also is rising—debt subject to limit will grow rapidly. This is what happened in the years before unified surpluses appeared in 1998. Back then, there was a recurrent need to raise the ceiling on debt subject to limit because both of its components were growing rapidly. This is the situation in which we again find ourselves in 2002.

Debt subject to limit also can grow if the unified budget surplus is smaller than the trust fund surpluses. In this case, publicly held debt would be declining, but not declining fast enough to offset the growth of debt to the trust funds. The rising level of debt subject to limit in this case indicates that we are "invading" the trust funds to pay for general government. In this case, the trust funds are building up a stock of Treasury bonds that they can cash in later to pay for future benefits. However, the buildup does not correspond to an improvement in the government's overall ability to finance those benefits because the rest of government isn't shedding its future obligations at the same rate.

Debt subject to limit can decline only if unified budget surpluses exceed the trust fund surpluses and the budget does not "invade" the trust fund surpluses. In this situation, which we enjoyed in fiscal years 1999 and 2000, the gross debt declines, receding from its statutory limit.

The reason that the Administration wants Congress to vote hastily to increase the debt limit now is that we are running unified budget deficits, and debt held by the public is again growing. Debt held in government trust funds is still expected to grow, though somewhat more slowly than expected a year ago. By contrast, projections a year ago showed sizeable unified budget surpluses leading to rapid declines in publicly held debt that easily outstripped the continuing buildup of obligations to pay future Social Security and other benefits. At that time, the only reason the Administration believed we might need to raise the debt limit in 2008 or 2009 was because it thought that unified surpluses would be so large that there would be no more publicly held debt to retire.

What Are the Short-run and Long-run Implications of the Need to Raise the Debt Limit?

The shift of the date at which the debt limit is breached from 2009 to the present is quite dramatic, illustrating the equally dramatic deterioration of the long-term fiscal outlook. It may be necessary to pass legislation raising the debt ceiling so that we can avoid a government default and fund our national priorities, including the war effort. However, such action should serve as an impetus for the Congress and the President to return to the path of long-term fiscal discipline that was abandoned because of the Republican tax cut.